THREE Principles of AGRICULTURAL COOPERATION

FCS Educational Circular 13
Farmer Cooperative Service
U. S. Department of Agriculture

THE Farmer Cooperative Service conducts research studies and service activities of assistance to farmers in connection with cooperatives engaged in marketing farm products, purchasing farm supplies, and supplying business services. The work of the Service relates to problems of management, organization, policies, merchandising, product quality, costs, efficiency, financing, and membership.

The Service publishes the results of such studies, confers and advises with officials of farmer cooperatives; and works with educational agencies, cooperatives, and others in the dissemination of information relating to cooperative principles and practices.

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This educational circular is one of a series prepared for use of members of farmer cooperatives and for educational work with rural youth.

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Three Principles of Agricultural Cooperation

COOPERATION, or working together, is not a new idea—it is as old as mankind. It has existed in many forms, and these varied forms have depended largely upon the conditions under which people live and the nature of their problems. For the most part, people have cooperated in the way best adapted to meet the problems before them.

In the early colonial days, and later in frontier settlements, the farming people had "house raisings," "log rollings," and "quilting bees." These were cooperative methods of meeting certain economic needs of the farmers whose production in those days was confined almost entirely to things used by their own families.

It is a long jump from those self-sufficing agricultural units to commercial agriculture as we know it today. Farmers now produce primarily for market. Production has become specialized in sections best adapted to the growth of certain crops.

On the other hand, as the result of our factory system, population has become concentrated in cities and other industrial areas. Only about one-eighth of the people in the United States live on farms. Approximately 20 percent of the United States population live in the three Eastern States of New York, New Jersey, and Pennsylvania, and another 20 percent live in the five States of Ohio, Indiana, Illinois, Michigan, and Wisconsin.[1]

Thus farmers for the most part have become widely separated from the consumers of their products. For similar reasons supplies used in farm production must often be transported long distances.

The volume of farm products marketed or supplies purchased by each individual farmer is relatively small. A farmer acting alone can do very little to improve conditions as they relate to his marketing and purchasing problems. Individually farmers are weak in bargaining power. However, through cooperative effort farmers have been able to increase their bargaining power and bring about efficiencies and improvements in selling their products and purchasing their farm supplies and services.

When you join a cooperative, you and other farmers who are members simply combine portions of your farm business into a joint enterprise

[1] 1950 Census.

NOTE.—Ward W. Fetrow, formerly Chief of the Cotton and Oilseeds Branch, Farmer Cooperative Service, prepared the text for the first issue of this publication. Slight revisions for this printing have been made by John H. Heckman, Chief, Membership Relations Branch, and Kelsey B. Gardner, Director, Management Services Division, Farmer Cooperative Service.

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and move it to town. It is still just as much your farm business as it was when you handled your part at the home farm. To operate your farm successfully you must understand its program and the principles behind the program. The same is true of the part of your farm business that you have combined with similar parts of your neighbors' farm businesses—your farmer cooperative.

This circular discusses cooperative principles only as they apply to the business phase of your organization. Cooperatives also have certain ideals of democracy and human relationships which make the cooperative something more than just another business. The protection and strengthening of these ideals demand practical and everyday application of the principles.

The three fundamental principles that distinguish farmer cooperatives from businesses of other types are:

1. Democratic control by members
2. Payment for capital limited to a conservative rate
3. Sharing the benefits and savings in direct proportion to the patronage of the individual member.

The last two principles are aimed at the same objective of the cooperative—namely to furnish goods or services to the owner-patrons at

cost. To achieve this all expenses of operating the cooperative are paid. This includes payment for the use of the members' money the cooperative is using. Any funds remaining after these costs have been paid are returned to the patrons in proportion to their use of the cooperative. When this has been done, the cooperative has no remaining funds as income to itself.

None of these principles is arbitrary or accidental. All three of them simply provide the rules of action which have been found necessary to accomplish the cooperative purpose. And the cooperative purpose is to furnish services and goods to the member patrons at cost—either essential service and goods at lower expense or better services and goods than are otherwise available.

Experience has demonstrated the wisdom of adhering to these three fundamental principles of cooperation. The following pages explain them in more detail, show to what extent they are recognized by both National and State legislation, and illustrate how the operating practices of the cooperative stem from the three fundamentals.

The First Principle: Democratic Control

COOPERATIVES are economic democracies. Democratic control is the foundation of all democracies. This is a universally recognized principle of agricultural cooperation. In the operation of a cooperative, democratic control is based on the fact that those who own the organization and are to benefit from it control it. If they do not control the cooperative, the benefits they are seeking from it may disappear.

In other words, the benefits you expect through your cooperative are services or goods of the kind you want at cost. Any savings your association makes belong to you and the other members. To protect your savings, you and your fellow members must control your organization on a democratic and equitable basis.

In the usual business corporation, voting or control is associated with the amount of stock held. This is logical and proper because the primary object of businesses other than cooperatives is return on capital invested, and capital, therefore, is the logical basis of organization and control.

But the primary object of a cooperative is not profit but services at cost. For this reason capital cannot be a fair basis of control in the cooperative. The control of a cooperative should be either on the basis of one-man, one-vote or on the basis of the amount of business the individual contributes to his association.

The reason for this is almost self-evident. If money were the basis of control in the cooperative, it would be possible for a few members with large investments to outvote a majority who are the major patrons. They could decide the services to be rendered instead of the ones who are the greatest users. They could vote for the use of savings of the association in paying large dividends or returns on their invested capital. The very purpose of the cooperative—services adopted to members' needs at cost—would be defeated.

Democratic control of the cooperative is usually accomplished by

voting on the basis of "one-member, one-vote." This method of voting is considered fundamental by many cooperative leaders. It has the advantage of making difficult any concentration of power in the hands of a few. The cooperative laws in over one-half of the States provide that no member or holder of common stock shall be entitled to more than one vote regardless of the amount of common stock owned in the association or the amount of patronage furnished.

Variations in Methods of Voting

Where the patronage of the members is equal or nearly so, it is fair that the voting rights be equal. However, there may be wide variations in the patronage of members of the organization. Large farmers contribute more patronage than small farmers. In such cases, because of the greater responsibility and risk involved, the large grower has some justification for desiring a greater voice in determining policies of the association.

It is the usual practice in farmer cooperatives to allow each member at least one vote, but some cooperatives allow additional votes to members. In these instances the additional votes are usually based on the number of shares of stock in the association, or on the amount of patronage furnished. If voting is on the basis of number of shares of stock, a limitation is frequently placed on the number of shares one member may own.

If additional votes are given for patronage, they are usually based on volume of product delivered, either in quantity or dollars. A few associations allow members additional votes based on acres, number of trees, dairy cows, or some other unit. In most cases a limit is placed on the additional votes which may be given, because of patronage, to any one member.

Two surveys of farmer cooperatives in the United States indicated that about 86 percent of the farmer marketing and purchasing associations followed the practice of "one-member, one-vote." Twelve percent based voting on equity in the association and only 1 percent based voting on patronage.

It is evident, of course, that in large associations each member cannot directly take part in formulating all policies and operating procedures for the association. Broad policies may be determined by the members, but the operating policies are determined by the board of directors.

The board is elected by members from among themselves. Board members are the representatives and trustees of those who elect them. They are charged with the responsibilities of determining the operating policies of the association and checking the effectiveness of its use of these policies. If a majority of the members become dissatisfied with the policies adopted by their directors, they have an opportunity—usually once a year or oftener—to elect directors to carry out different policies. The majority rules in a cooperative.

Just as there are variations among cooperatives in the manner of assuring democratic voting control, there also are variations in methods of voting. Associations use different methods of electing directors. Also the number of directors, the length of their term of office, and the methods of membership contact and education and of supervising management policies

Here, in annual meeting, a cooperative uses the one-member, one-vote method of making decisions.

may all differ materially from association to association. Although these differences exist in methods of operation, the associations may uniformly adhere to the fundamental of democratic control.

The Second Principle: Limited Returns on Capital

CAPITAL is as necessary in a cooperative as in any other business. It is needed to provide buildings and equipment, and to furnish funds for day-to-day operations. But since a cooperative operates at cost, margins remaining after payment of authorized expenses are in reality savings for its members.

This calls for effective use of the capital necessary in conducting the business of the association. This means that it limits the interest it pays for capital to the "going rate"—just as it pays its wages, salaries, rent, and other items on a fair basis of what these services are worth.

Persons who invest in other types of business are interested in placing their money where they can obtain as large a return as possible, consistent with safety. Their primary motive is to make a profit on the dollars invested. Capital assumes all of the risk. It is, therefore, fair that it should have all the earnings after wages, salaries, rent, and other expenses are paid.

In a cooperative, on the other hand, capital is paid for just as labor, land, and management. After all expenses are paid, the members are entitled to the remainder. If the operations have not been successful, the members lose. They lose either through taking less for their products or through a decrease in their equity in the cooperative.

In other words, it is the members who assume the major business risk in the cooperative as such—not capital. It is the members who gain major benefits on the basis of their individual use of the cooperative's services—not on their capital investment. Ideally stated, the coop-

erative itself can neither make a profit nor sustain a loss—although the members can gain or lose through their cooperative's operations.

Statutes Set Interest Rate

Limitation of returns on capital by farmer cooperatives is recognized in both Federal and State laws. These laws specify the maximum returns that may be paid on invested capital. Cooperatives may pay any amount they choose less than the maximum. The limit in most of the State statutes is fixed at 8 percent. A few of the States place the limit lower than 8 percent.

The Federal cooperative law—the Capper-Volstead Act—recognizes the principle of limited returns on capital by setting a maximum interest rate of 8 percent if members vote on any basis other than one-man, one-vote. In addition, a cooperative must limit dividends on its capital stock to 8 percent or less, among other things, if it is to qualify for exemption from payment of income taxes under the Federal revenue statutes.

This legislative recognition of the limitation of returns on capital in a cooperative business enterprise did not come about by accident. Such legislation merely provided legal sanction to a business procedure already recognized as sound among cooperatives. Adherence to this principle has sometimes been lax. Some associations in many instances have gradually lost their cooperative character because control was based on capital with no limit placed on returns on capital.

The Third Principle: Sharing Savings in Proportion to Patronage [2]

WHEN farmers join together to market their crops or obtain their supplies and needed services, a sufficient volume of business is one of the first requirements toward selling or buying most effectively. Patronage is, therefore, a necessary contribution of the member to his cooperative.

If a cooperative accomplishes its objective, it does one or both of two things—it furnishes essential services or goods at lower cost than otherwise possible, or it supplies better services or goods than are otherwise available.

The member's benefits from his cooperative may show up in any of a number of ways. Lower handling costs may reflect themselves in a higher net return at the time he markets a crop. Better services and quality of farm supplies also may add up to a better price. The member's economic gain through his cooperative will come to him in the form of patronage refunds at the end of some definite period or as increased returns from the sale of his products on a basis of pooling sales returns.

Patronage refunds furnish a means by which operations on a cost basis can be conveniently carried out. If all costs could be figured in advance, it would be possible to return to the farmer all his savings through his cooperative at the end of every day or every transaction, but such is obviously impos-

[2] This principle completes the procedure for operating at cost.

sible. Costs are overestimated to provide a margin of safety. Any savings resulting from the overestimates are allowed to accrue until they can conveniently be distributed.

This distribution may be based on either the value or the number of units of products handled. For example, a farmer who delivers 10,000 bushels of grain to his cooperative elevator has contributed 10 times as much to the business of his association as the farmer who delivers only 1,000 bushels. If the savings amount to 1 cent a bushel, the farmer who delivered 10,000 bushels would be entitled to $100 and the other farmer to only $10.

Accrued Savings Aid Financing

Patronage refunds thus are a convenient means of reflecting to the members the cooperative's savings in direct proportion to each member's business. They are also a means of conveniently helping the member finance his cooperative.

In other words savings are not always paid in cash. They are often retained for capital purposes. Evidences of ownership are issued as certificates or other forms showing that the member has a certain amount of accumulated savings credited to his name.

Some associations maintain only book credits as evidences of member contributions to capital. When the cooperative uses these accumulated savings of the members for capital purposes, the members are sharing in the financing of their association in direct proportion to the use they make of the association's services. When sufficient capital is thus built up, the earliest certificates are redeemed in cash.

This revolving method of financing is simply the ultimate phase of the basic cooperative philosophy that each member support his organization to the extent he uses it and benefits from it.

Cooperative statutes place limitations on the amount of nonmember business which may be done by a cooperative. The Capper-Volstead Act provides that an association shall not deal in the products of nonmembers to an amount greater in value than that handled by it for members. Nonmember business is prohibited by some State laws. Others permit nonmember business only in case the nonmember shares in patronage refunds. Certain provisions on the methods of distributing savings are contained in the cooperative laws of the various States. Some statutes provide for educational reserves or require that a certain portion of savings be set aside as reserves until these reserves equal a certain percentage of the capital.

Putting the Cooperative Principles to Work

EACH cooperative principle has a reason behind it—the reason being to enable the cooperatives to accomplish their purpose. The principles, however, are simply rules for action. They are useless unless they are followed by practices which put them into operation.

Success, of course, is not guaranteed even if cooperative principles are strictly followed. A cooperative is a business, and as a business

it also must follow sound business principles. Capable management, an adequate financial structure, effective operations—these are some of the business prerequisites that must be added to the cooperative formula in order that the cooperative may do its job.

Many of the problems of farmer cooperatives arise from a failure to follow the three cooperative principles herein described. When control of an association has slipped away from the members, for example, it usually has been because of a failure to tie in the voting privilege with active patronage of the association. Failure to limit the rate of return on capital has often followed this first weakness, or else was a contributing ailment in the first place.

The cooperative laws which have been referred to were designed to maintain control by the members. It is important to note that the laws relating to the operation of cooperatives did not establish the principles of cooperation. Rather, in cooperative development, the practice has preceded the law. An attempt has been made through legislation to protect the cooperative nature of farmers' associations and assist them in maintaining their cooperative status.

There were no laws, either Federal or State, applying specifically to cooperatives when the first ones began. It soon became apparent, however, that the nature of the cooperative business made it necessary to enact special legislation applying specifically to such organizations if they were to have an opportunity to function so as to benefit the participants. Laws were needed to parallel those which previously had been enacted for the benefit of general corporations operating for profit. Laws reflect public attitudes.

The attitude of the public toward farmer cooperatives in this country is expressed in both State and National legislation. In general this legislation has encouraged and fostered these farmer businesses. Each of the States has one or more laws providing for the incorporation of farmer cooperatives and containing other provisions which protect and encourage such associations. A number of the Federal laws indicate that Congress recognizes the right of farmers to act together through cooperatives.

In the final analysis it is up to the members to insist that their cooperatives observe the three principles herein described if they want all the advantages of a real cooperative. This is the first step toward the second and equally essential step of securing and maintaining efficient management and sound operating practices.

Some Questions on Cooperatives in Your Community

1. What are the three fundamental principles that distinguish these farmer cooperatives from other types of business in your community?

2. What method of voting is used in electing the board of directors? How many directors are there? What is the length of their term of office? How many members voted at the last election?

3. How much capital has been contributed by the members? What rate of interest was paid on this capital for the last business year? Do you think this is a reasonable rate? On what do you base your answer?

4. Do these associations pay patronage refunds? What was the total amount paid during the last fiscal year? What basis was used in distributing these refunds among the patrons? Were the refunds in cash, in stock, or in some other evidence of capital contribution?

5. Are these cooperatives farmer-owned, farmer-controlled associations operated for the benefit of those who furnish the business? What is the basis for your answer?

6. Why should cooperatives have democratic control, limited returns on capital, and pay savings on a patronage basis?

7. What commodities are handled? What are the principal services rendered?

8. What provisions are contained in the cooperative act of your State on voting, payment of interest on capital, and patronage refunds?

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You and Your Co-op Series

OTHER circulars in this series are available from the Farmer Cooperative Service, U. S. Department of Agriculture, Washington 25, D. C. The series includes:

The Story of Farmer Cooperatives, FCS Educational Circular 1.

Using Your Wool Co-op, FCS Educational Circular 2.

Guide for Teaching Farmer Cooperation, FCS Educational Circular 3.

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